

**STATE OF MICHIGAN**  
**IN THE SUPREME COURT**

**IN RE REQUEST FOR ADVISORY OPINION  
REGARDING CONSTITUTIONALITY OF  
2011 PA 38**

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**Supreme Court No. 143157**

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**JOINT BRIEF AMICUS CURIAE OF:**

**Business Leaders for Michigan  
Small Business Association of Michigan**



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## **STATEMENT OF BASIS OF JURISDICTION**

The Michigan Constitution permits the Governor to “request the opinion of the supreme court on important questions of law upon solemn occasions as to the constitutionality of legislation after it has been enacted into law but before its effective date.” Const 1963, art 3, § 8. On May 31, 2011, the Governor requested an Advisory Opinion from this Court as to 2011 Public Act 38, which was granted by Order dated June 15, 2011. This Court has jurisdiction pursuant to Const 1963, art 3, § 8 and MCR 7.301(A)(4).

## STATEMENT OF QUESTIONS PRESENTED<sup>1</sup>

- I. Whether reducing or eliminating the statutory exemption for public-pension incomes as described in MCL 206.30, as amended, impairs accrued financial benefits of a “pension plan [or] retirement system of the state [or] its political subdivisions” under Const 1963, art 9, § 24?
- II. Whether reducing or eliminating the statutory tax exemption for pension incomes, as described in MCL 206.30, as amended, impairs a contract obligation in violation of Const 1963, art 1, § 10 or the US Const, art I, § 10(1)?
- III. Whether determining eligibility for income-tax exemptions on the basis of total household resources, or age and total household resources, as described in MCL 206.30(7) and (9), as amended, creates a graduated income tax in violation of Const 1963, art 9, § 7?
- IV. Whether determining eligibility for income-tax exemptions on the basis of date of birth, as described in MCL 206.30(9), as amended, violates equal protection of the law under Const 1963, art 1, § 2 or the Fourteenth Amendment of the United States Constitution?

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<sup>1</sup> By Order dated June 15, 2011, the Supreme Court directed that the following four questions were submitted for review and consideration.

## **I. INTRODUCTION AND STATEMENT OF INTEREST**

Amici Curiae<sup>2</sup> herein share a common and active interest in the State's economic revitalization, which unquestionably requires reformation of the current tax system. Business Leaders for Michigan ("BLM") is an organization dedicated to making Michigan a "Top Ten" state for job and economic growth. Its members include chairpersons, chief executives and senior executives of the State's largest job providers and universities. BLM's work is defined by the Michigan Turnaround Plan, which includes a detailed plan for reforming the State budget, managing the State's finances, and creating jobs to help Michigan become a competitive force. A significant part of this Plan includes reforming the current tax system in a manner that will both raise revenue and create incentives for businesses to operate and thrive throughout the State.

The Small Business Association of Michigan ("SBAM") is the only statewide and state-based association that focuses solely on serving the needs of Michigan's small business community. SBAM's mission is to help Michigan small businesses succeed by promoting entrepreneurship, leveraging buying power and engaging in political advocacy. SBAM recognizes the challenges of running a successful small business and is dedicated to removing legislative, regulatory, economic or other barriers to success. SBAM is committed to reformation of the current tax system in order to improve the overall economic climate in Michigan.

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<sup>2</sup> Amici Curiae Business Leaders for Michigan and the Small Business Association of Michigan, are collectively referred to herein as "Amici Curiae."

Amici Curiae’s respective members are deeply committed to legislative and policy changes that will move Michigan forward and improve the economic climate for the benefit of all the State’s residents. The Michigan Legislature approved major reforms to the Michigan tax law and structure through the enactment of 2011 Public Act 38 (“2011 PA 38”). Prior to the effective date of certain provisions, the Governor requested an Advisory Opinion as to the constitutionality of 2011 PA 38, which was granted on June 15, 2011. The following questions were submitted for review:

Does 2011 PA 38:

- 1) impair accrued financial benefits of a pension plan of the state (Const 1963, art 9, § 24);
- 2) impair contractual obligations (Const 1963, art 1, § 10; US Const, art I, § 10(1));
- 3) create a graduated income tax (Const 1963, art 9, § 7); or
- 4) violate equal protection of the law (Const 1963, art 1, § 2; US Const, Fourteenth Amendment)?

In granting the Governor’s request for an Advisory Opinion, this Court also invited “groups interested in the determination of the questions presented” to request permission to file briefs amicus curiae.<sup>3</sup> Amici Curiae unequivocally and collectively support these amendments to the Income Tax Act, and respectfully request that this Court uphold the constitutionality of 2011 PA 38.

## **II. STATEMENT OF FACTS**

Of the 41 states with income taxes, only 10 offer an income tax deduction or exemption that excludes all state and local government pension income from taxation. *See* National Conference of State Legislatures “State Personal Income Taxes on Pensions & Retirement

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<sup>3</sup> Amici Curiae, by separate motion, have requested leave to file this brief.

Income: Tax Year 2010” (February 2011). The Michigan income tax exemption, as enacted in 1969, originally extended only to the receipt of retirement benefits paid under a state or local retirement plan. *See* 1969 PA 332. The exemption for retirement benefits paid under a state or local pension plan resulted in the entire amount of pension benefits received being excluded from Michigan taxable income.

*Davis v Michigan Dep’t of Treasury*, 489 US 803, 817; 109 S Ct 1500; 103 L Ed 2d 891 (1989), required, by virtue of the intergovernmental tax immunity doctrine, retirement benefits received by retired federal employees to be afforded the same tax treatment as retirement benefits received by Michigan public employees. In response to *Davis*, the Michigan Legislature expanded the tax exemption for retirement benefits to include retirement benefits paid to retired federal employees. *See* MCL § 206.30(f)(i).<sup>4</sup>

In an effort to provide some equality to the treatment of the taxation of retirement benefits from private pension plans, the Michigan Legislature expanded the exemption for retirement benefits to include benefits paid from private sector pension plans in 1974. *See* 1974 PA 217. Section 30(f)(iv) of the Michigan Income Tax Act, MCL 206.30(f)(iv), was most recently amended in 2007 to increase the partial exemption to allow retirement benefits received under all other pension plans to be deducted up to a maximum amount, determined each year by the percentage increase in the Consumer Price Index (“CPI”). *See* MCL § 206.30(f)(iv). For the 2010 tax year, the maximum exemption is equal to \$45,120 for a person filing a single return and \$90,240 for a joint return. In addition to the exemption for retirement benefits set forth in Section

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<sup>4</sup> The United States Supreme Court had instructed the State to either expand the exemption to include federal employees or, alternatively, withdraw the exemptions altogether, at least implicitly suggesting that no exemption was necessary. If that is the case, certainly a reduction in the exemption, such as the one created by 2011 PA 38, would also be allowed.

30(f) of the Michigan Income Tax Act, four of the acts establishing public retirement systems contained language excluding retirement benefits from taxation.<sup>5</sup>

Currently, all social security, public pension income and most private pension income are deductible from state income tax. Beginning in tax year 2012, with the effectiveness of 2011 PA 38, tax treatment of retirement income will vary dependent on the age of the taxpayer. The tax exemptions in SERA, PSERA, MLRS and CLERSA were also amended to expressly provide that benefits paid under the respective public retirement systems are “subject to state tax upon distribution to the person....” 2011 PA 41 (SERA); *see also* 2011 PA 42 (PSERA); 2011 PA 43 (MLRS); and 2011 PA 44 (CLERSA).

To illustrate the changes, set forth below is a brief explanation setting forth in relevant part the existing treatment of retirement income compared to what is contemplated by 2011 PA 38.

#### **Current Law**

- Social security and public pensions are deductible
- Private pensions are deductible up to \$45,120 single/\$90,240 joint

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<sup>5</sup> These four public retirement systems are (1) the State Employees Retirement Act, 1943 PA 240, as amended, (“SERA”), (2) Public School Employees Retirement Act of 1979, 1980 PA 300, as amended, (“PSERA”), (3) the Michigan Legislative Retirement System Act, 1957 PA 261, as amended, (“MLRS”), and (4) City Library Employees’ Retirement Systems Act, 1927 PA 339, as amended, (“CLERSA”). For example, SERA provides:

The right of a person to a pension, an annuity, a retirement allowance, any optional benefit, any other right accrued or accruing to any person under the provisions of this act, the various funds created by this act, and all money and investments and income of the funds, *are exempt from any state, county, municipal, or other local tax.* MCL 38.40 (emphasis added).

PSERA, MLRS and CLERSA contain similar language.

- 401(k)s with no employer match are subject to tax; 401(k)s with employer match are partially deductible

### **Treatment under 2011 PA 38 (tax year 2012)**

#### **Age 67 or older in 2012 (born before 1946):**

- No change

#### **Between 60-66 years old in 2012 (born between 1946 and 1952):**

- Exemption of \$20,000 single/\$40,000 joint against pension and retirement income
- Social security deduction and eligible for personal exemption
- If Household Resources (“HHR”)<sup>6</sup> exceed \$75,000 single/\$150,000 joint, cannot take \$20,000/\$40,000 joint exemption

#### **Upon turning 67...**

- Exemption of \$20,000 single/\$40,000 joint against all types of income
- Social security deduction and eligible to take personal exemption
- If HHR exceeds \$75,000 single/\$150,000 joint, cannot take \$20,000 single/\$40,000 joint exemption

#### **If under 60 years old in 2012 (born after 1952):**

- No pension or retirement exemption under 67 years of age
- Social security deduction

#### **Upon turning 67:**

- Exemption of either (1) \$20,000 single/\$40,000 joint against all types of income or (2) social security deduction and personal exemption
- If HHR exceeds \$75,000 single/\$150,000 joint, cannot take \$20,000 single/\$40,000 joint exemption

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<sup>6</sup> HHR includes all income (taxable and nontaxable) received by all adult household members that is used for household expenses during the year.

### III. STANDARD OF REVIEW

In the context of this Advisory Opinion, a standard of review is not applicable. Constitutional questions are reviewed de novo. *Toll Northville LTD v Township of Northville*, 480 Mich 6, 10-11; 743 NW2d 902 (2008). The questions presented in this proceeding raise the issue whether 2011 PA 38 violates the Michigan Constitution of 1963 or the United States Constitution. The principles of constitutional interpretation are well established. Review of the constitutionality of 2011 PA 38 is guided by the rule “that legislation is ‘clothed with the presumption of constitutionality’ and must be sustained if within constitutional limits.” *Request for Advisory Opinion on Constitutionality of 1986 PA 281*, 430 Mich 93, 106; 422 NW2d 186 (1988) (quoting *W A Foote Mem Hosp v Jackson Hosp Auth*, 390 Mich 193, 209; 211 NW2d 649 (1973)). The presumption of constitutionality “is particularly strong when addressing tax legislation.” *Taxpayers United for Mich Const v City of Detroit*, 196 Mich App 463, 466-67; 493 NW2d 463 (1992). “[I]t is also well established that a taxpayer does not have a vested right in a tax statute or in the continuance of any tax law.”<sup>7</sup> *City of Detroit v Walker*, 445 Mich 682, 703; 520 NW2d 135 (1994). “[T]hose arguing against the constitutionality of a [Public Act] must bear the burden of proof.” *Request for Advisory Opinion on Constitutionality of 1986 PA 281*, 430 Mich at 107. Accordingly, 2011 PA 38 is presumed to be constitutional and those opposing its constitutionality must bear the burden of proof to establish otherwise.

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<sup>7</sup> Similarly, in the context of federal tax law, the United States Supreme Court has recognized that “reliance [upon tax laws] alone is insufficient to establish a constitutional violation. Tax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code.” *United States v Carlton*, 512 US 26, 33; 114 S Ct 2018; 129 L Ed 2d 22 (1994).

#### IV. ARGUMENT

- A. **Question 1: Whether Reducing Or Eliminating The Statutory Exemption For Public-Pension Incomes As Described In MCL 206.30, As Amended, Impairs Accrued Financial Benefits Of A “Pension Plan [or] Retirement System of the State [or] its Political Subdivisions” under Const 1963, art 9, § 24?**

Amici Curiae adopt and incorporate herein the arguments set forth in the Brief of Attorney General in Support of the Constitutionality of 2011 PA 38 (“Proponent’s Brief”), and the Brief of Amici Curiae Michigan Chamber of Commerce, *et al* with respect to Question #1.

- B. **Question 2: Whether Reducing Or Eliminating The Statutory Tax Exemption For Pension Incomes, As Described In MCL 206.30, As Amended, Impairs A Contractual Obligation In Violation Of Const 1963, art 1, § 10 Or The US Const, art I, § 10(1)?**

Amici Curiae adopt and incorporate herein the arguments set forth in the Proponent’s Brief and the Brief of Amici Curiae Michigan Chamber of Commerce, *et al* with respect to Question #2.

- C. **Question 3: Whether Determining Eligibility For Income-Tax Exemptions On The Basis Of Total Household Resources, Or Age And Total Household Resources, As Described In MCL 206.30(7) And (9), As Amended, Creates A Graduated Income Tax In Violation Of Const 1963, Art 9, § 7?**

1. **The Michigan Constitution Prohibits A Graduated Income Tax As To Rate Or Base.**

The Michigan Constitution provides in relevant part as follows:

No income tax graduated as to rate or base shall be imposed by the state or any of its subdivisions.

Const 1963, art 9, § 7 (“Art 9, § 7”). A graduated income tax is one in which the rate varies with the amount of income (graduated rate) or one in which the rate is consistent, but the base against which it is imposed varies (graduated base). See, e.g., Citizens Research Council of Michigan, Volume 809 (October 2, 1968). Federal income tax is graduated as to rate, meaning the rate varies at different levels of income. *Id.* An income tax graduated as to base occurs when a flat rate is applied to a base that is graduated, meaning based on federal income tax liability. *Id.* Because the amount of federal income tax due is determined by applying a graduated rate to taxable income, the net effect of a flat state income tax applied to federal income tax liability is the same as imposing a graduated state income tax at rates scaled down from the federal rates.

**2. Settled Principles of Constitutional Construction Dictate That a Graduated Base, as Prohibited by Art 9 § 7, Refers only to a Base Premised on Federal Income Tax Liability, otherwise known as a “Piggyback” Tax.**

“Each provision of a State Constitution is the direct word of the people of the State, not that of the scriveners thereof, and therefore we must never forget that it is a Constitution we are expounding.” *Michigan United Conservation Clubs v Secretary of State*, 464 Mich 359, 373; 630 NW2d 297 (2001) (“MUCC”) (quotations omitted). The Court’s primary goal in construing a constitutional provision is to give effect to the intent of the people who ratified the Constitution by applying the rule of “common understanding.” *Id.* The rule of common understanding is as follows:

In construing our constitution, this Court’s object is to give effect to the intent of the people adopting it.... Hence the primary source for ascertaining its meaning is to examine its plain meaning as understood by its ratifiers at the time of its adoption.

*Id.* at 507 (citations omitted);<sup>8</sup> see also *People v Nutt*, 469 Mich 565, 574 n 7; 677 NW2d 1 (2004):

[O]ur task is not to impose on the constitutional text at issue...the meaning we as judges would prefer, or even the meaning the people of Michigan today would prefer, but to search for contextual clues about what meaning the people who ratified the text in 1963 gave to it. [Citing *MUCC, supra*, at 375 (Young, J, concurring)].

The proper inquiry, therefore, is what did the people intend when they voted to ratify Art 9, § 7. Constitutional Convention debates and the Address to the People are the primary evidence available today as to what was intended 50 years ago and are thus highly relevant aids in determining the intent of the ratifiers. *Id.* at 574; see also *id.* at 590, n 26:

The Address to the People, widely distributed to the public prior to the ratification vote in order to explain the import of the sundry proposals, ‘is a valuable tool in determining whether a possible common understanding diverges from the plain meaning of the actual words of our constitution.’ (Quoting *MUCC, supra*, at 378, 379 n 11 (Young, J, concurring)).

As explained by this Court in *MUCC, supra*, the Address to the People is particularly compelling evidence of the ratifiers’ intent and understanding. The Address, which was officially approved by the members of the Constitutional Convention, provided the text of each proposed provision and, in simple language, commentary as to each proposed provision, explaining its importance in a manner that the public would understand. *Id.* at 378. Indeed, the Address was widely

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8 This Court agreed with Justice Cooley’s explanation of the rule of “common understanding” in *Federated Publications, Inc v MSU Bd of Trustees*, 460 Mich 75, 85; 594 NW2d 491 (1999), quoting Cooley, *Constitutional Limitations* (6th Ed), p 81 as follows: “A constitution is made for the people and by the people. The interpretation that should be given it is that which reasonable minds, the great mass of the people themselves, would give it. For as the Constitution does not derive its force from the convention which framed, but from the people who ratified it, the intent to be arrived at is that of the people, and it is not to be supposed that they have looked for any dark or abstruse meaning in the words employed, but rather that they have accepted them in the sense most obvious to the common understanding, and ratified the instrument in the belief that that was the sense designed to be conveyed.” *Id.* at 374.

distributed to the public prior to the ratification vote in order to fully educate the public about the proposed Constitution. *Id.* at 378-379. Both the Address to the People and the Convention Comments constitute an “authoritative description of what the framers thought the proposed constitution provided” and are therefore “a valuable tool” in determining the common understanding of the actual words used in the Constitution. *Id.* at 379, n 11; *see also Regents of Univ of Mich v Michigan*, 395 Mich 52, 60; 235 NW2d 1 (1975).

The history of Art 9, § 7, which was added to the Constitution in 1963, clearly indicates that the term “or base” was included solely to prevent the Legislature from circumventing the graduated rate prohibition by assessing a flat tax based on federal tax liability. Official records from the Constitutional Convention unequivocally support this conclusion:

The provision makes it clear that neither the state nor any local unit of government may impose a graduated income tax. The words ‘or base’ are necessary to prevent ‘piggyback’ taxation based on the Federal tax liability. Without such language, a tax nominally imposed at a flat rate might actually adopt all of the graduation of the federal tax. A flat rate income tax is clearly permitted, and could, in the opinion of the committee, be imposed on a ‘piggyback’ basis on income computed for federal tax purposes. The legislature could prescribe reasonable exemptions for a flat rate income tax.

1 Official Record, Constitutional Convention 1961, p 854. That the words “or base” were included for precisely this purpose also appears from the record of debate. See 1 Official Record, Constitutional Convention 1961, pp 893, 894; Address to The People, 2 Official Record, Constitutional Convention 1961, p 3399, reprinted as annotation to Art 9, § 7 in MCLA:

This is a new section making it clear that neither the state nor any local unit of government may impose a graduated income tax. The words ‘or base’ are necessary to prevent ‘piggyback’ taxation based on the federal tax liability. Without such language, a tax nominally imposed at a flat rate might actually adopt all the graduation of the federal tax. A flat rate income tax is clearly permitted, and could be imposed on a ‘piggyback’ basis on income

computed for federal tax purposes. The Legislature could prescribe reasonable exemptions for a flat rate tax.

*See also Butcher v Dep't of Treasury*, 425 Mich 262, 269, n 12; 389 NW2d 412 (1986).

A review of the plain language of Art 9 § 7, and its history, reveal the inescapable conclusion that the exemptions at issue do not create a graduated base as contemplated by the people in 1963. The critical and, in fact, only relevant inquiry, is what was the “common understanding” of the term “graduated base” at the time it was ratified by the voters. A graduated rate clearly is a rate that increases as income increases, as is currently done in the federal system and was done on multiple levels back in 1963. Indeed, at that time, the federal rate had more than 20 different brackets that varied based on income. The obvious intent of the ratifiers, therefore, was to prohibit a similar system in the State, and to apply a flat rate across the board.

The term “graduated base,” however, is not a common term. Because a graduated rate means a rate that varies by income, then, on its face, a graduated base must be construed to mean a base that varies by income. Given, however, that a tax base by its nature must rise as income rises (to which a flat rate would apply) it could not possibly have been the intent of the people to prohibit such a variation. Therefore, because the term “graduated base” cannot possibly mean what the simplest reading would suggest, and it is not now nor at the time of its ratification a term of art, the only logical conclusion is that it means exactly what was stated in the Address to the People, nothing more nothing less. The addition of the term “or base” was to prevent circumvention of the prohibition of a graduated rate by applying a flat rate to federal income tax liability, *i.e.* a “piggyback” on the federal tax. The Address to the People, Convention Comments and annotation to this constitutional provision all state precisely the same thing, namely the

inclusion of a prohibition as to a graduated base was only to prevent a piggyback tax. There was no other purpose to the addition of the words “or base.”

### **3. The Allowance Of Deductions Or Exemptions From Taxable Income Does Not Create A Graduated Income Tax.**

Since the adoption of Art 9, § 7 in 1963, this Court and the Court of Appeals have had several opportunities in which to analyze this constitutional prohibition as applied to the State’s tax laws, and have consistently held, consistent with the intent of the ratifiers, that Art 9, § 7 does not prevent the Legislature from granting exemptions or deductions from taxable income. *Kuhn v Dep’t of Treasury*, 15 Mich App 364; 166 NW2d 697 (1968), aff’d as mod 384 Mich 378; 183 NW2d 796 (1971), was the first case in which this Court directly addressed the applicability of Art 9, § 7 to the Income Tax Act. Specifically, the plaintiffs alleged that both the allowance of \$1200 for dependent personal exemptions, and the credits for property and income taxes violated Art 9, § 7. The Court of Appeals easily rejected the plaintiffs’ contention that the exemptions were unconstitutional, holding as follows:

The Michigan constitutional provision prohibiting an income tax graduated as to rate or base prohibits only different rates of tax on different segments of taxable income of the person being taxed. *It does not prohibit the exclusion or exemption from the definition of taxable income of a portion of the taxed person’s receipts.*

What the people sought to prohibit was the imposition of the kind of graduated income tax imposed by the Federal government. Of course, the legislature may not accomplish by indirection that which it may not do directly. We have carefully reviewed the objections advanced by the plaintiffs with that in mind. We are persuaded that the tax imposed does not impose the kind of tax which the constitutional provision prohibits.

*The words ‘or base’ in the phrase ‘no income tax graduated as to rate or base shall be imposed’ prohibit only the imposition of a so-called piggyback income tax, i.e. one based on a taxpayer’s*

*Federal tax liability.* A piggyback income tax, if enacted, would have the effect of imposing an income tax graduated as to rate.

15 Mich App at 369-371 (emphasis added).

This Court affirmed the Court of Appeals' decision in *Kuhn*, adopting the analysis of the Court of Appeals, and unequivocally holding that Art 9, § 7 does not prohibit the Legislature from granting exemptions from or credits against taxable income to those taxpayers that qualify. Specifically, this Court concluded as follows:

Plaintiffs say that the classification of taxpayers into three categories and the Act's provisions allowing credits for property tax and income tax liability violate Michigan Constitution of 1963, art 9, § 7, prohibiting an income tax graduated as to rate or base. *As the Court of Appeals said, that prohibition only applies to different rates of tax on different segments of taxable income of the person being taxed. It does not prohibit the exclusion or exemption from the definition of taxable income of a portion of the taxed person's receipts. Undoubtedly what the drafters and adopters of that provision in the 1963 Michigan Constitution had in mind was the graduated scheme of the Federal income tax in which rates increase as taxable income does, and that power they wished to deny to the state.* Neither the designation of three types of taxpayers with different applicable rates to each, nor the difference in exemptions or exclusions causes this Act to run amiss of that wish and does not violate art 9, § 7. *The rates of tax imposed by the Act are uniformly applicable to all taxable income of every taxpayer in each class.*

384 Mich at 388-89 (emphasis added).

Several years later, the Court of Appeals addressed a similar challenge to the property tax credit and sales tax credit provisions of the Income Tax Act in *Rosenbaum v Mich Dep't of Treasury*, 77 Mich App 332; 258 NW2d 216 (1977). The plaintiffs argued that the formula to be applied in determining eligibility for the property tax credit, which was in essence a credit of that amount which the property tax exceeded 3.5% of the plaintiff's total household income, operated to impose a higher tax rate upon those with higher incomes. The Court flatly rejected the notion that simply because income was a criteria for determining eligibility for the credit it was

unconstitutional. The Court reasoned that eligibility for the property tax credit was not based solely on the taxpayer's income but, rather, on two independent variables, namely: (1) household income; and (2) property tax. "Manipulation of the variables can yield results which do or do not appear to create a graduated rate depending on the assumptions used. We could by arbitrary manipulation make the credits vary only with changes in household income as the plaintiffs have done in their brief, but that clearly is not the necessary result of the statute." *Id.* at 335.

Similarly, in *Stockler v Mich Dep't of Treasury*, 75 Mich App 640; 255 NW2d 718 (1977), the plaintiff sought a declaration that the single business tax ("SBT") was unconstitutional because the small business exemption amounted to a graduation of base, given it was determined solely on the basis of business income. This argument was succinctly rejected by the Court of Appeals, as follows:

The rate is a flat 2.35%. The base does not become graduated merely because of exemptions or exclusions.

*Id.* at 652.<sup>9</sup> The Court was clearly not persuaded by the suggestion that determination of exemption eligibility based solely on income criteria necessarily rendered the statute unconstitutional. The allowance of exemptions or exclusions, even based on income criteria, simply does not render the tax base graduated, it merely reduces the taxable income to which the flat tax applies.

The last time this Court directly addressed Art 9, § 7 was in *Butcher, supra*. In *Butcher*, the plaintiffs alleged that the property tax credit reduction formula, which decreased the property tax credit for persons with higher incomes, was unconstitutional because it created a graduated income tax contrary to Art 9, § 7. This Court concluded that the property tax credit was not in

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<sup>9</sup> The *Stockler* Court concluded that the SBT was not an income tax and, therefore, not subject to Art 9, § 7, but, "assuming arguendo" that it was, concluded it was not a graduated income tax. 75 Mich App at 652.

fact an income tax credit even though it was applied against state income tax liability. Instead, this Court concluded that it was a property tax rebate available regardless of income tax liability, and therefore could not possibly violate Art 9, § 7. Contrary to what is stated in the Attorney General's Brief Opposing the Constitutionality of 2011 PA 38 ("Opponent's Brief"), however, the *Butcher Court* did not hold that an income-dependent exemption that affected income tax liability would violate Art 9, § 7. Opponents' Brief at 47. Rather, whether the credit would have violated Art 9, § 7, had the Court deemed it to be to an income as opposed to a property tax, was never squarely addressed. It is important to note, however, that although the Court made this technical distinction in *Butcher*, thereby significantly simplifying the analysis, the property tax credit, which was available only to taxpayers under certain income levels, was applied to reduce income tax liability. Indeed, it is significant that every Michigan court to address the issue has held that eligibility for an exemption based on income criteria does not result in a graduated income tax base as prohibited by the Michigan Constitution. In fact, every holding has been precisely to the contrary.

Soon after *Butcher, supra*, the Court of Appeals addressed another challenge to the SBT as violative of Art 9, § 7 in *Town & Country Dodge, Inc v Dep't of Treasury*, 152 Mich App 748; 394 NW2d 472 (1986), which was again rejected:

Although it is true that the amount taxed is based upon federal taxable income, *a tax base does not become graduated simply because it incorporates exemptions or exclusions. A tax is graduated where it imposes a different taxing rate on different segments of a single taxpayer's income.* While it is true that the federal income tax is a graduated tax, the single business tax *is not based on the taxpayer's graduated federal tax liability but on taxable income.*

*Id.* at 754 (citations omitted) (emphasis added).

Case law in Michigan is therefore consistent with the stated intent of the drafters, as ratified by the voters. The sole purpose of Art 9, § 7 was to prohibit a graduated tax rate. Including the language “or base” was only to prevent the Legislature from circumventing the graduated tax rate prohibition by imposing a flat rate tax on federal income tax liability, which is of course calculated based on a graduated rate. The drafters expressly stated that they did not intend to preclude the Legislature from granting exemptions or deductions from taxable income, which purpose was ratified by the voters. *See* 1 Official Record, Constitutional Convention 1961, p 854, *supra*, Address to the People, *supra*. Michigan precedent is in accord with this stated intent and “common understanding.”

Moreover, as set forth above, *supra*, the Convention Records specifically state that a flat rate income tax could “be imposed on income computed for federal tax purposes.” 1 Official Record, 1961, p 854. The drafters, therefore, were clearly not concerned about income-based exemptions at the federal level flowing to the State form (given that federal adjusted gross income (“AGI”) is determined after calculation of numerous exemptions and deductions). There are, in fact, several income-based exemptions that flow through to the Michigan tax base including, for example, the Social Security exemption. The constitutional prohibition could not, therefore, have been intended to prevent income-based exemptions, as these have historically been a part of the federal tax system and calculation of AGI, the starting point for determining Michigan tax liability. Art 9, § 7, in contrast, only prohibits federal tax *liability* from being the starting point (or tax base) for determining Michigan income tax liability, because that number is calculated after application of a federal graduated rate. There is no prohibition, however, and in fact it is expressly contemplated that Michigan income tax will be calculated by applying a flat

rate to AGI, which takes into account all federal exemptions and deductions, including those that are income-based.

**4. Determining Eligibility For Retirement Income Exemptions Based On Total Household Resources and Age Does Not Violate Art 9, § 7.**

Opponents contend that it is unfair that a person's eligibility for the retirement income exemption depends in part on total household resources, thereby rendering the tax base graduated, because in theory those with higher incomes will pay more because they will not qualify for this exemption. This argument must also fail; income criteria used to determine eligibility for a deduction or exemption does not render a tax base graduated.

First, it is important to note that not every taxpayer has retirement income and, even if they do, that income is not deductible in every instance. 401(k) contributions not matched by employers, for example, are taxable under existing law. So the first requirement for those that could potentially be eligible for a deduction is limited to those with certain types of retirement income. Therefore, thousands of taxpayers in Michigan are not eligible for this exemption now or pursuant to 2011 PA 38, because they receive no qualifying retirement benefits.

Second, a determination of whether one is eligible for this exemption is not based on income but, rather, two independent variables, namely age and total household resources. In fact, those over a certain age are completely unaffected by 2011 PA 38. Younger folks remain eligible for a limited deduction for retirement income, unless their total household resources exceed \$75,000 single/\$150,000 joint. Those between 60 and 66 are treated more leniently than those under 60 years of age, given the obvious fact that such individuals are closer to retirement, if not already retired.

Accordingly, 2011 PA 38 only impacts a limited population, namely those that (1) have certain types of retirement income, (2) are younger than 67, and (3) have total household resources that exceed a certain threshold. As held in *Kuhn, Rosenbaum* and their progeny, simply because income is a factor in determining eligibility for a deduction or exemption does not render the tax statute violative of Art 9, § 7.

Indeed, similar to *Kuhn* and *Rosenbaum*, income criteria is only one of multiple variables used to determine eligibility for the exemptions here at issue. For eligible persons over the age of 67, they can deduct their entire retirement income regardless of total household resources. For those that are younger, if after computation of the variables a deduction is allowed, it is permitted to reduce the retirement income component of taxable income in the same manner as any deduction or exemption reduces taxable income. The tax base of each individual remains taxed at the same rate, regardless of their eligibility for this or any other exemption or deduction. This is just one of many possible factors that go into determining a taxpayer's taxable income.

In this instance, there are multiple variables used to determine eligibility for the exemption. As a threshold matter, one must have retirement income, which is a relatively small subset of the population of Michigan taxpayers. Second, one must be in a certain age bracket. Third, one must have HHR under a certain amount, and, as discussed below, HHR is very different from income used to calculate tax liability. As a result of these variables, taxpayers with vastly different incomes qualify for the retirement income exemption and those with vastly different incomes get no exemption. Art 9, § 7 only requires that the same rate apply to all taxable income, meaning what remains after all deductions and exemptions are calculated. 2011 PA 38 complies with that requirement and is not substantively different from any other exemption, credit or deduction enacted by the Legislature to reduce taxable income.

**5. Eligibility For A Personal Exemption Is Determined Based On Total Household Resources, Filing Status, and Whether One Claims the \$20,000/\$40,000 Exemption.**

Currently, the personal exemption is \$3700 for each exemption claimed on a federal return. Effective January 1, 2012, the personal exemption will be based on HHR, filing status and whether one claims the \$20,000/\$40,000 exemption. Taxpayers with HHR of less than \$75,000 single/\$150,000 joint can receive the full \$3700 exemption; taxpayers with HHR greater than \$100,000 single/\$200,000 joint receive no personal exemption and those in between receive a pro rata exemption.

In contrast to the exemption for retirement income, personal exemptions apply to everyone. Opponents argue this amendment creates a graduated tax base because those with higher incomes will have a higher base than those with lower incomes, because they will not be eligible for the personal exemption. Being eligible for certain deductions or exemptions, however, does not render a base graduated, a conclusion that has been reached consistently by this Court. *See, e.g., Kuhn, supra.* A graduated base is one that is computed based on federal income tax liability, which is not the case here. Every taxpayer remains subject to the same rate and their base size is determined by the amount of their income less applicable deductions and exemptions. The personal exemption is only one component of the overall tax base and determination of an individual's taxable income. Taxpayers' bases will obviously vary. The only relevant inquiry is whether the base itself is computed based on federal income tax liability, not whether the base has been reduced by an exemption or deduction, even if eligibility for same is determined in part by income factors. Eligibility for the exemption merely reduces the base for certain taxpayers to which a singular tax rate is applied to all.

Moreover, one exemption alone does not determine the size of the taxpayer's tax base. A taxpayer with a higher adjusted gross income can end up with a smaller tax base due to a mix of exemptions, deductions and credits. The social security exemption, for example, will also reduce the tax base for some people and not for others. Therefore the fact that an exemption contains an income disqualifier does not mean the higher income individuals will necessarily have proportionately higher tax bases relative to AGI than lower income individuals. It depends on their overall eligibility for deductions, exemptions, etc. In addition, the HHR is not the same calculation as AGI. HHR does not factor in the federal deductions and exemptions at all and, in fact, can result in a very difficult income calculation from AGI, meaning determination of eligibility for the personal exemption does not necessarily correlate with income for tax purposes. Moreover, those that do qualify for a personal exemption may qualify for one such exemption or multiple exemptions, depending on the size of their family, which will necessarily reduce their tax base based solely on factors entirely unrelated to income. Further, certain taxpayers claiming the \$20,000/\$40,000 exemption may not claim any personal exemptions.

As stated by the Court of Appeals, in *Kuhn*, and affirmed by this Court:

The Michigan constitutional provision prohibiting income tax graduated as to rate or base prohibits only different rates of tax on different segments of taxable income of the person being taxed. It does not prohibit the exclusion or exemption from the definition of taxable income of a portion of the taxed person's receipts.

15 Mich App at 364, 369-70; 384 Mich at 388. Eligibility for a personal exemption based on total household resources, filing status, and whether one claims the \$20,000/\$40,000 exemption does not violate Art 9, § 7.

There are sound governmental reasons for permitting those with less total household resources to be eligible for certain exemptions. Likewise, individuals with higher incomes tend to have greater deductions in other areas, such as charitable deductions and capital losses,

because they have more discretionary income. The only relevant query for this constitutional analysis is whether the taxpayers are getting taxed, directly or indirectly, at a different *rate* based on their income. The answer to that question is clearly no. Every individual's taxable income, determined after calculation of their applicable deductions and exemptions, remains taxed at precisely the same rate, both before and after enactment of 2011 PA 38.

**D.     Question 4: Whether Determining Eligibility For  
Income-Tax Exemptions On The Basis Of Date Of  
Birth, As Described In MCL 206.30(9), As Amended,  
Violates Equal Protection Of The Law Under Const  
1963, Art 1, § 2, Or The Fourteenth Amendment Of  
The United States Constitution?**

**1.     Exemptions From Taxation Do Not Violate  
Equal Protection Of The Law.**

It is well settled that the Legislature may choose to exempt certain persons from taxation. *CF Smith Co v Fitzgerald*, 270 Mich 659; 259 NW 352 (1935). In *Lehnhausen v Lake Shore Auto Parts Co*, 410 US 356; 93 S Ct 1001; 35 L Ed 2d 351 (1973), the United States Supreme Court held that a state constitutional provision exempting individuals from personal property taxes, but not corporations and other non-individuals, did not violate equal protection. The Court's holding makes it clear that an equal protection challenge to a tax statute will almost never succeed, because the Legislature is unquestionably permitted to treat people differently for purposes of taxation. The Court set forth the test for assessing equal protection challenges to taxation as follows:

The Equal Protection Clause does not mean that a State may not draw lines that treat one class of individuals or entities differently from the others. The test is whether the difference in treatment is an invidious discrimination.

*Where taxation is concerned and no specific federal right, apart from equal protection, is imperiled, the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation.*

\* \* \*

There is a presumption of constitutionality which can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes. The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it.

410 US at 359, 364 (quotations and citations omitted)(emphasis added); *see also Covert Twp Assessor v State Tax Comm*, 407 Mich 561, 597; 287 NW2d 895 (1980) (Tax statutes may discriminate as long as the discrimination is not “arbitrary but is based upon a reasonable distinction or if any state of facts can reasonably be conceived to sustain it.”).

In applying an equal protection analysis to a tax statute, it is well recognized that although the statute may draw lines that appear “arbitrary or unjust,” that is not a sufficient basis to strike it down. *Ludka v Dep’t of Treasury*, 155 Mich App 250, 263; 399 NW2d 490 (1987).

The power of exemption would seem to imply the power of discrimination, and in taxation, as in other matters of legislation, classification is within the competency of the legislature. *Granting the power of classification, we must grant Government the right to select the differences upon which the classification shall be based, and they need not be great or conspicuous...* The State is not bound by any rigid equality. This is the rule; its limitation is that it must not be exercised in clear and hostile discriminations between particular persons and classes... Thus defined and thus limited, it is a vital principle, giving to the Government freedom to meet its exigencies, not binding its actions by rigid formulas but apportioning its burdens and permitting it to make those discriminations which the best interests of society require.

*Id.* (quoting *Banner Laundering Co v Gundry*, 297 Mich 419, 433-34; 298 NW 73 (1941)); *see also Gauthier v Campbell, Wyant & Cannon Foundry Co*, 360 Mich 510, 514; 104 NW2d 182 (1960) (“A classification having some reasonable basis does not offend against [the equal

protection] clause merely because it is not made with mathematical nicety, or because in practice it results in some inequality.”); *Stockler*, 75 Mich App at 649 (Court rejected plaintiffs’ argument that the SBT violated the equal protection clause because plaintiff was required to pay both state income tax and SBT tax while others (corporations, financial institutions and domestic insurers), did not. “It appears that plaintiff’s actual quarrel is that the act is oppressive. This may well be true; however, harshness does not render a tax unconstitutional.”).

**2. Rational Basis Is The Applicable Test For  
Analyzing An Equal Protection Challenge To  
2011 PA 38.**

Analysis of an equal protection challenge to a tax statute is identical under both the federal and state constitutions. *Armco Steel Corp v Dep’t of Treasury*, 419 Mich 582, 591; 358 NW2d 839 (1984). Because the issue before this Court involves a tax statute which does not concern any special rights or classifications, the rational basis test applies. *Allied Stores of Ohio, Inc v Bowers*, 358 US 522; 79 S Ct 437; 3 L Ed 2d 480 (1959). Indeed, it has long been recognized that age is not a suspect class. *Gregory v Ashcroft*, 501 US 452, 470; 111 S Ct 2395; 115 L Ed 2d 410 (1991); *see also Muller v Lujan*, 928 F2d 207, 210 (CA 6, 1991). Therefore, a governmental classification based on age need only satisfy rational basis scrutiny, *i.e.* the classification must be reasonably related to a conceivable goal or purpose of the classification. *Id.*; *Armco*, 410 Mich at 592.

The opponents, however, make the remarkable argument that 2011 PA 38 is subject to strict scrutiny because pension income constitutes an accrued financial benefit guaranteed by the Michigan Constitution under Art 9 § 24. Public pensions are, therefore, a “fundamental right,” for equal protection purposes according to the opponents. Opponents’ Brief at 53.

As a threshold matter, this entire argument must fail, because there is no right under the Constitution not to be taxed, as discussed in detail in the Proponents' Brief and the Brief of Amici Curiae Michigan Chamber, *et al*, with respect to Question #1. That fact alone renders this novel theory fatally flawed.

Secondarily, to argue that the "right" not to be taxed on a public pension is a "fundamental right" is disingenuous, at best. As this Court stated with approval in *People v Bennett* (After remand), 442 Mich 316, 327, n 13; 501 NW2d 106 (1993):

A fundamental right has been defined as that which the United States Supreme Court recognizes as having a value so essential to individual liberty in our society that it justifies the justices reviewing the acts of other branches of government.

*Id.* (quoting 2 Rotunda & Nowak, Const Law (2d Ed), § 15.7 p 427). The United States Supreme Court explained further as follows:

In determining which rights are fundamental, judges are not left at large to decide cases in light of their personal and private notions. Rather, they must look to the traditions and (collective) conscience of our people to determine whether a principle is so rooted (there) as to be ranked as fundamental. The inquiry is whether a right involved is of such a character that it cannot be denied without violating those fundamental principles of liberty and justice which lie at the base of all our civil and political institutions.

*Griswold v Conn*, 381 US 479, 493; 85 S Ct 1678; 14 L Ed 2d 510 (1965) (citations and quotations omitted).

Contrary to opponents' assertions otherwise, this Court has in fact previously held that the State's Constitution provides protections identical to the federal Constitution for purposes of equal protection. *Doe v Dep't of Social Services*, 439 Mich 650, 673; 487 NW2d 166 (1992). Fundamental rights are extremely limited and include only those guarantees essential to an individual's liberty, such as the right to vote and travel, due process in criminal matters and the specific guarantees of the Bill of Rights. *See, e.g. Palmer v Bloomfield Hills Bd of Educ*, 164

Mich App 573, 577; 417 NW2d 505 (1987); *People v Bennett*, *supra*. Fundamental rights do not include, as opponents erroneously and without any authority assert, every constitutional guarantee. See, e.g. *Palmer*, *supra*, at 577 (“The mere fact that the Michigan Constitution of 1963 mentions education, while the federal constitution does not, provides no justification for abandoning past decisions and holding education to be a federal right under the Michigan Constitution. The federal constitution ignores education because regulation of education and school is a traditional state function.”). Accordingly, the delineations set forth in 2011 PA 38 based on age are subject only to rational basis review.

Pursuant to rational basis, the Court does not “determine the wisdom, need, or appropriateness of [the State’s] tax exemption powers or whether the classification scheme achieves mathematical equality.” *Gilson v Dep’t of Treasury*, 215 Mich App 43, 50; 544 NW2d 673 (1996). The classification scheme created by the statute must simply be rationally related to a legitimate government purpose. *Id.*

There are several cases that have directly addressed the constitutionality of treating retirees differently for tax purposes. In *Gilson*, *supra*, for example, the question before the Court was whether treating retirees who receive pension funds from out of state public retirement systems differently from retirees who receive pension funds from the State of Michigan, or another pension retirement system with a reciprocal tax exemption for retirees, is rationally related to a legitimate government purpose. The Court held that treating these classes of retirees differently served two legitimate purposes sufficient to satisfy rational basis. First, it furthered Michigan’s interest in hiring and retaining qualified civil servants, and second, it served as an inducement for other states to treat Michigan public servants in the same manner as if they had chosen to retire in Michigan. See also *Harvey v Michigan*, 469 Mich 1; 664 NW2d 767 (2003)

(equal protection challenge to Judge's Retirement Act, which granted a greater retirement allowance to 36th District Court judges than to all others rejected; Legislature's desire to induce competent and qualified attorneys to become judges or remain judges in the City of Detroit was a rational basis for the disparity in benefits); *Molter v Dep't of Treasury*, 443 Mich 537; 505 NW2d 244 (1993) (Court rejected plaintiff's challenge to the automatic withdrawal of taxes from deferred compensation and interest earned by nonresident retired Michigan state employees but not former residents who received distributions from private employer defined compensation plans, noting that income tax was due by both private and public employees receiving distributions under deferred compensation plans; the difference in the manner or type of collection, *i.e.* in this instance withholding, did not trigger equal protection concerns).

It has also long been recognized that the Legislature may treat persons differently for tax purposes to protect taxpayers' reasonable reliance intents. In *Nordlinger v Hahn*, 505 US 1; 112 S Ct 2326; 120 L Ed 2d 1 (1992), for example, the United States Supreme Court addressed an equal protection challenge to an acquisition value system of taxation in California, whereby property was reassessed up to the current appraised value for a new construction or a change in ownership. Exemptions were available only for exchanges of principal residences by persons over age 55 and transfers between parents and children. Over time, the system resulted in significant disparities in the taxes paid by persons owning similar pieces of property.

The Supreme Court explained that the relevant inquiry was whether the difference in treatment between newer and older owners rationally furthered a legitimate state interest, which only required a plausible policy reason for the classification. *Id.* at 11. The Court further noted that this standard was "especially deferential in the context of classifications by complex tax laws. In structuring internal taxation schemes, the states have large leeway in making

classifications and drawing lines which in their judgment produce reasonable systems of taxation.” *Id.* (quoting *Williams v Vermont*, 472 US 14, 22; 105 S Ct 2465; 86 L Ed 2d 11 (1985)). The Court concluded that the California system passed constitutional muster because there were at least two rational reasons to justify the difference in treatment. First, the state has a legitimate interest in local neighborhood preservation, continuity and stability, which was furthered by a system which promoted long-term ownership. Second, the state could conclude that a new owner does not have the same reliance interest warranting protection against higher taxes as does an existing owner. A new owner knows what he is getting into in terms of tax liability when making the decision to purchase a property, whereas an existing owner does not have the option whether to buy his home should the taxes become prohibitively high. As explained by the United States Supreme Court, protecting the reliance interests of taxpayers is a recognized justifiable basis for classifications in tax laws.

This Court previously has acknowledged that classifications serving to protect legitimate expectation and reliance interests do not deny equal protection of the laws. *The protection of reasonable reliance interests is not only a legitimate governmental objective: it provides an exceedingly persuasive justification.*

*Id.* at 13 (quotations omitted)(emphasis added)(citing *United States RR Retirement Bd v Fritz*, 449 US 166, 178; 101 S Ct 453; 66 L Ed 2d 368 (1980))(denial of windfall retirement benefits to some railroad workers but not others did not violate equal protection; those who had actually acquired statutory entitlement to windfall benefits while still employed in the railroad industry had a greater equitable claim than those no longer in railroad employment whom became eligible for benefits).

The Supreme Court thus upheld the overall assessment scheme as constitutional. With respect to the challenge concerning the exemptions, which plaintiffs contended rendered the system even more unfair, the Court noted that for purposes of rational basis review, the

Legislature's discretion is broad in determining whether to grant partial or total exemptions upon grounds of policy. *Id.* at 447. Because the exemptions furthered legitimate purposes, including that older people should not be discouraged from moving to residences more suitable to their changing family size or income, they easily passed constitutional muster. *Id.* See also *Ludka, supra* (Plaintiff's equal protection challenge to allowance of a credit to income tax for Canadian provincial income tax, but not for income tax paid to other foreign governments, was rejected; the purpose was clearly to prevent the individual from being triply taxed due to the income tax system in Canada, satisfying the rational basis test).

In this case, the Legislature has made classifications based on age to determine eligibility for exemptions from tax for public and other pension income. The age differentiations are clearly designed to protect the reliance interests of those individuals who are already retired or eligible for retirement, which interests are clearly more significant the older the individual. For those individuals under 60 years old, many are still years from retirement and, in fact, may still choose to take a different job or otherwise plan for retirement, taking into consideration the changes to the tax laws, whereby those who are older do not have any options. Protecting the reliance interests of the older taxpayers is not only a recognized state interest but, as stated by the Supreme Court in *Nordlinger*, "provides an exceedingly persuasive justification." 505 US at 13; *see also Dillinger v Schweiker*, 762 F2d 506, 508 (CA 6, 1985) (amendments to Social Security Act making two levels of benefits which turned on whether retiree reached certain age before or after a specified date was rationally related to the goal of protecting solvency of social security system and protected reliance interests of those already receiving or eligible for benefits).

Given that 2011 PA 38 is a tax statute pursuant to which the Legislature is granted wide latitude in making classifications and drawing lines, it easily passes constitutional muster. The

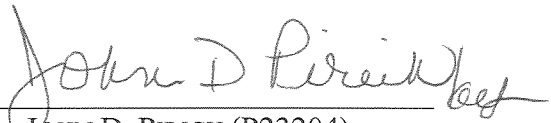
State of Michigan is in the midst of an economic crisis and can only balance the budget and hope to recover by increasing revenue and cutting costs. Most states tax pension income as does the federal government; Michigan is fairly unique in this regard. The Legislature has determined that given the reality of the State's economic situation, many difficult decisions need to be made in an effort to move the State in the right direction. Taxing pensions is a relatively painless, reasonable and fair manner in which to raise money for the State, which is unquestionably in dire straits. Recognizing, however, that there are many state employees who have retired or on the verge of retirement and cannot possibly prepare for this change in tax treatment given their age, the Legislature determined it was reasonable to have a three tiered system based on age to protect those reliance interests. It is a fair, caring and reasonable distinction that easily defeats any equal protection challenge.

#### **V. RELIEF REQUESTED**

Amici Curiae herein respectfully request that this Honorable Court uphold the constitutionality of 2011 PA 38 with respect to each of the questions submitted for an Advisory Opinion.

Respectfully submitted,

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